E,G-002/D-92-869 ORDER PARTIALLY ACCEPTING AND PARTIALLY REJECTING DEPRECIATION PROPOSAL

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of a Request by Northern States Power Company for Certification of Depreciation Rates for 1993

ISSUE DATE: April 23, 1993

DOCKET NO. E,G-002/D-92-869

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PROCEDURAL HISTORY

On July 31, 1992, Northern States Power Company (NSP or the Company) filed its 1992 five-year average life depreciation study for transmission, distribution and general property, pursuant to Minn. Rules, parts 7825.0500 through 7825.0900.

On January 15, 1993, the Department of Public Service (the Department) submitted its report and recommendation. The Department recommended that the Commission accept the Company's filing, thus certifying the proposed service lives, net salvage values, and resulting depreciation rates.

No other party submitted comments.

The matter came before the Commission on April 8, 1993.

FINDINGS AND CONCLUSIONS

I. The Depreciation Rules

Minn. Rules, parts 7825.0500 through 7825.0900 create a procedure for Minnesota gas and electric utilities to calculate proposed depreciation rates, methods and schedules. Under the rules, the Commission must analyze the filings submitted by the utilities and certify the depreciation rates and methods it finds reasonable and proper.

Minn. Rules, part 7825.0700 requires every utility to file a petition for depreciation certification, including specified schedules, at least every five years.

Minn. Rules, part 7825.0800 prescribes the straight-line method for calculating depreciation, excluding depletion, accruals. Any exceptions to the straight-line method must be specifically justified by the utility and certified by the Commission.

II. The Straight-line Method of Depreciation and the ASL Method of Estimating Probable Service Lives and Net Salvage Values

Commission rules currently require the straight-line method of calculating depreciation. Under this method, the original cost of an asset, adjusted for net salvage, is charged to operating expenses and/or to clearing accounts and credited to the accumulated provision for depreciation through equal annual charges over its probable service life. Minn. Rules, part 7825.0500, subp. 14.

The "average service life" (ASL) method has been accepted by the Commission as one means of estimating probable service lives and net salvage values. Under the ASL method, individual items are grouped into accounts according to similar characteristics. The average lives and net salvage values are estimated, based on actuarial studies and experience. The average lives and net salvage values enter into calculations to arrive at an annual depreciation rate. When that rate is applied to the account balance, the result is the annual depreciation expense and the addition to depreciation reserve. Under the ASL method, items continue to depreciate within their respective accounts until actually retired from service; at that time, a retirement order is processed to the accounts.

III. NSP's Proposal

NSP's proposed changes to the ASL filing for electric transmission and distribution accounts would increase the annual depreciation accrual by approximately $4.8 million, based on December 31, 1992 figures. Most of the increase is due to lower scrap values and higher costs of removing retired plant.

Changes proposed by NSP for the gas utility would decrease the annual depreciation accrual by approximately $151,000, based on December 31, 1992 data. NSP's supporting data showed certain factors which accounted for rising costs of removing plant and other factors which accounted for decreasing costs. NSP reported that it has experienced major retirements of gas mains due to the St. Paul area sewer separation project.

For General Plant accounts, NSP proposed a major change to its method of accounting for depreciation. With the exception of the Structures and Improvements account (which would remain under the ASL method), NSP proposed changing from the ASL method to an amortization method of accounting. Under this system, items would still be grouped according to type. Within those groups, items would be maintained by vintage, according to year of placement into service. Rather than estimating service lives, the Company would use the official tax lives for groups of items, referring to the Tax Code from the year of placement into service. The annual accrual and addition to reserve would be calculated by taking the original cost of the equipment (by vintage) and subtracting the related reserve (by vintage) and dividing the number of years remaining in the amortization period (again, by vintage). Retirement orders would no longer be necessary for depreciation purposes. Net salvage would not be used to reduce the amount amortized for the current vintage. Instead, net salvage realized when the equipment is retired from service would be entered in the year of retirement, resulting in a reduction of future amortizations.

NSP advanced a number of justifications for its proposed change in depreciation accounting for General Plant. According to the Company, General Plant contains many items of relatively small value with diverse characteristics; the amortization method would eliminate tracking individual units and completing retirement work orders, resulting in greater efficiency. The amortization method would encourage employees to strive for higher salvage values in the future, because the actual salvage values would reduce future budgets. The amortization method would eliminate the situation under the ASL method in which fully depreciated items continue to depreciate until all units within an account are fully depreciated. NSP noted that the FERC has allowed the amortization method for a Philadelphia utility. Finally, the proposed method would reduce depreciation expense for General Plant by approximately $4.75 million, based on December 31, 1992 data.

IV. Commission Analysis

The Commission is satisfied with NSP's five-year ASL studies of gas and electric transmission and distribution accounts. NSP supplied detailed schedules and narrative support for its proposed studies. Satisfactory explanations were given for any slight deviations of actual experience from long term estimates. The Commission will accept the Company's filings of these studies.

The Commission is not prepared at this time to accept the Company's proposed change to depreciation accounting for General Plant. While the Commission sees some merit and potential in NSP's proposed method, there are also possible downsides to the change. The proposed method, which would amortize plant at a pace faster than its service life, without incorporating the related estimated salvage value, could result in less accurate matching between costs and service provided. The ASL method has been used by NSP and other Minnesota utilities for years; the amortization method is relatively untested at this time. The proposed method would not factor in the generally positive salvage values until the asset is retired from service. As a result, there could be a long term investment in General Plant by present ratepayers, while the rewards of salvage savings could fall to future ratepayers.

Because the Commission will reject the Company's proposed change in depreciation accounting at this time, present rates and methods for the General Plant will remain in effect. The Commission notes, however, that it remains open to the submission of a more fully documented proposal in the future. It is possible that future study may show that the efficiencies and potential savings of the amortization method outweigh any possible drawbacks. It is also possible that the present proposal could be modified in the future to reduce the downsides of the method. As an example, a proposal could include lives which more accurately reflect the probable service life and salvage value portions of the depreciation rules. The Commission will fully consider any proposed change in depreciation accounting methods submitted by NSP in the future.

V. Future Procedure

The depreciation rates and methods certified in this Order are binding on all future rate proceedings and remain in effect until the next depreciation certification, or until otherwise changed by the Commission. Minn. Rules, part 7825.0900. Specific dollar amounts of gross plant, depreciation reserve, annual accrual and dollars to be allowed as additional depreciation are subject to audit. The inclusion of items in this Order for depreciation purposes does not guarantee their inclusion in rate base for ratemaking purposes.

Companies are required by law to review their depreciation rates annually to ensure that they are still generally appropriate. Depreciation certification studies must be made so that all primary accounts shall have been analyzed every five years. Minnesota Rules, part 7825.0600, subps. 2 and 3.

ORDER

1. The Commission certifies depreciation rates according to the findings of this Order, as shown on Attachment A attached to and incorporated into this Order.

2. Accruals to the depreciation reserve for each account shall be determined by calculating an annual depreciation rate, using average service life and net salvage estimates, and multiplying that rate by the original cost of depreciable plant in the account.

3. In the event any class of plant shall become fully depreciated by the use of these rates, then no further depreciation accrual for such class of plant shall be made.

4. The Company shall file its next five-year depreciation study on or before July 31, 1997.

5. The rates certified by this Order are effective January 1, 1993.

6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)